

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: AUG 18 2000

Contact Person: [REDACTED]

ID Number: [REDACTED]

Telephone Number: [REDACTED]

[REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated on [REDACTED] under the nonprofit laws of the State of [REDACTED]. Your stated purposes are to be organized and operated exclusively for charitable and educational purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, such purposes to be limited to providing low income housing to relieve the poor and distressed.

You plan to acquire land and construct or rehabilitate structures into affordable housing projects. You stated that any low and moderate income housing project that you acquire and operate will satisfy the "safe harbor" requirements of Rev. Proc. 96-32. You anticipate that your housing projects will qualify for tax exempt bond financing and/or the low income housing tax credit available under section 42 of the Code.

You have entered into purchase agreements to acquire [REDACTED] separate properties located in [REDACTED] and [REDACTED] located in [REDACTED]. You stated that there is no relationship by virtue of family ties, common ownership or course of dealings (other than in connection with these purchases agreements) between any of the sellers and you or any of your officers or members of your board of directors.

You intend to finance a substantial portion of the acquisition of the property with tax exempt bonds. No appraisals were conducted prior to the purchases of the properties. Instead, you based your offering prices on your knowledge of values and on the advice of your brokers. Your broker for these purchases was [REDACTED] ([REDACTED]). [REDACTED] vice president of [REDACTED] also sits on your board of directors. A broker's commission will be paid to [REDACTED] of 3 percent, which you have stated is customary in the real estate industry.

[REDACTED]

The projects will require extensive rehabilitation. However, a contractor has not yet been chosen. [REDACTED] will manage these properties as well as any future properties acquired by you. [REDACTED] will charge a management fee equal to 5 percent of gross income collected. You provided a study showing that the median management fee for the area including [REDACTED] is 4.5 percent of gross income with a low of 3.5 percent and a high of 5 percent. The median fee for the region including the State of [REDACTED] is 4.7 percent, with a low of 3.8 percent and a high of 5.1 percent. You related that in general fees for affordable housing are higher due to the additional record keeping and reporting requirements and provision of social service to tenants. No bidding process was used to determine the management company, and no other management companies were considered.

[REDACTED] provides free office space and free secretarial services to you. [REDACTED] is an officer and director of [REDACTED] and one of your officers and directors.

Other members of your board of directors include [REDACTED] and [REDACTED]. [REDACTED] is a shareholder in the law firm of [REDACTED], which represents your legal interests as well as those of [REDACTED]. [REDACTED] is a principal of [REDACTED] and [REDACTED] owns an accounting firm. You state that each board member may provide services to you.

You indicated that you intend to enter into limited partnership arrangements formed to acquire and own property using low income housing tax credits as a financing source. Under such a partnership you would serve as the general partner and would have an investor as the limited partner. You expect that negotiations with an investor would commence by soliciting proposals from all investors known to your officers and directors, although you have indicated that no officer or director is affiliated with any low income housing tax credit investor. You stated that each investor has its own form of limited partnership agreements, so the form would depend on the selection of the investor.

Section 501(c)(3) of the Code exempts from federal income tax, as provided in section 501(a), organizations organized and operated exclusively for exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term "charitable" in its generally accepted legal sense and it is not limited by the separate enumeration of exempt purposes in section 501(c)(3) of the Code. The term includes, inter alia relief of the poor and distressed.

Rev. Proc. 96-32, 1996-1 C.B. 717, provides that an organization will be considered to relieve the poor and distressed if it establishes that 75 percent of the units are occupied by residents that qualify as low income and that are either (a) 20 percent of the units are occupied by very low income residents or (b) 40 percent of the units are occupied by residents that do not exceed 120 percent of the area's very low income limit. In addition, the units must be affordable to the residents.

In the case of Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Court stated that "...the presence of a single...[non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of ... [exempt] purposes."

Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974), held that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

Leon A. Beeghly Fund v. Commissioner, 35 T.C. 490 (1960) held, that a charitable trust was not entitled to exemption under section 501(c)(3) of the Code when it engaged in transactions that benefited private individuals even though the transaction was also beneficial to the trust.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), aff'd in unpublished opinion, 647 F.2d 170 (9th Cir. 1981), several for-profit organizations exerted significant indirect control over est of Hawaii, a nonprofit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the nonprofit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion that est of Hawaii did not qualify as an organization described in section 501(c)(3).

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court concluded that an organization that trained campaign workers for the benefit of the Republican Party was not exempt under section 501(c)(3) of the Code due to the greater than incidental private benefit to the Party and to Republican Party candidates. The court noted that section 501(c)(3) organizations may benefit private interests only incidentally. Conferring more than incidental benefit on private interests is a nonexempt purpose.

Plumstead Theatre Society, Inc. v. Commissioner, 74 T.C. 1324 (1980), aff'd 675 F.2d 244 (9th Cir. 1982) ("Plumstead"), held that an organization's participation as a general partner in a

limited partnership did not adversely affect the organization's tax exempt status under section 501(c)(3) of the Code. In this case, the charitable general partners sold two-thirds of its half interest in the play to three for-profit investment limited partners in an arm's length transaction. The court based its decision on the fact that (a) the general partner was not obligated to return capital to the investors out of its own funds; (b) the limited partners had no control over the way the exempt organization managed its affairs; and, (c) none of the limited partners were directors or officers of the general partner. The opinion concludes that an interest in a single play is not intrusive or indicative of serving private interests.

Housing Pioneers, Inc. v Commissioner, TCM 1993-120, aff'd, 58 F.3d 401 (9th Cir. 1992), held that an organization's participation as a general partner in a limited partnership precluded exemption under section 501(c)(3) where the investors privately benefited from the arrangement. The opinion notes that section 501(c)(3) of the Code controls the exemption issue. It also notes that Plumstead does not apply because factually it differs from the instant case, because private benefit issues were raised when two of the limited partners were also board members of the general partner applying for tax exemption.

Rev. Proc. 90-27, 1990-1 C.B. 514, sets forth procedures with respect to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code.

Section 5.02 at Rev. Proc. 90-27 provides that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

As the above cited law, regulations and cases demonstrate, the conduct of activities for purposes described in section 501(c)(3) of the Code must be the exclusive purpose of an organization before it can be recognized as exempt from tax under section 501(a) of the Code. An organization is not operated exclusively for charitable purposes if the benefits to private individuals are more than an incidental consequence of its operations.

Aside from the benefits conferred on a charitable class of persons who reside in property you propose to acquire and operate, commercial interests will benefit from your proposed activities. These benefits consist of fees and commissions from real property transfers, property management, and other similar items.

You have a board of directors composed of interested persons who all conduct business with you. Transactions at fair market value with board members may be allowed. However, the determination to do business with a board member or other interested party with control in this case is not made by an independent disinterested board.

Although you have represented that fees paid will be at fair market value, this is not determinative of whether private interests are served more than incidentally because the mere acquisition of the insider contracts achieves the private purposes. The facts here suggest that an underlying purpose is to acquire real estate, financial services, and management contracts for the interested directors and officers, and as such, you have more than an insubstantial non-exempt purpose. Here there is no competitive bidding process for the management contract; and no apparent bidding process for other services. Even if a bidding process was established, however, the fact that interested directors select the contracts provides little assurance that private interests would not be served. Further, the fees paid are at the high end of the range of fees paid.

You have indicated that you intend to enter into limited partnerships with for-profit investors. However, you have not provided any details regarding the provisions of the partnership agreements, nor any indications as to who the for-profit investors will be. In order for an organization to establish that it qualifies for recognition of exemption it has the burden to establish that it is operating exclusively for charitable purposes. In order to establish your qualification for exempt status, it will be necessary to provide more information regarding the partnership arrangements, including identifying the limited partners and spelling out the rights and obligations of all parties.

Because you have not demonstrated you will be operated exclusively for charitable purposes, we conclude that you are not described in section 501(c)(3) of the Code and are not exempt under section 501(a). Accordingly, contributions to you are not deductible under section 170 of the Code. You must file federal income tax returns on Form 1120.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference; if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service,

[REDACTED]

TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
T:EO:RA:T:1 [REDACTED] Rm. 6514
1111 Constitution Ave, N.W.
Washington, D.C. 20224

To help further expedite our handling of this matter, you may fax your response at the following telephone number: (202) 622-9803. Please also mail the original of your response at the address listed.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

We have sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1

bcc: [REDACTED]

bcc: [REDACTED]

[REDACTED]